EXCEPTION

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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
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JIM IRVIN
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CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO. RE-00000C-94-0165

RUCO'S EXCEPTIONS TO RECOMMENDED OPINION AND ORDER

The Residential Utility Consumer Office ("RUCO") hereby submits its Exceptions to the Hearing Division's Recommended Opinion and Order ("Recommended Order"). RUCO's exceptions fall into three major areas: 1) the necessity of unbundling and properly setting the standard offer rate; 2) the necessity of a proper calculation period and market price determination for use in the recommended net revenues lost methodology; and 3) the necessity of a reasonableness review of divestiture sale price in the recommended auction/divestiture methodology.

A. The Standard Offer Rate Should Be Unbundled, With The Generation Rate Based On A Retail Market Price.

1. <u>The CTC Should Appear On All Consumers' Bills</u>.

The Recommended Order does not require the unbundling of standard offer rates, and would allow the Affected Utilities to place visible stranded cost charges ("Competition Transition Charges," or "CTC") only on the bills of customers who choose competitive generation. It is not in the public interest to hide stranded cost charges from standard offer customers in this manner. Consumers have the right to know what charges they are paying. If the CTC appear only on the bills of consumers who choose competitive generation, this could easily lead consumers to think they will pay stranded costs only if they choose to receive competitive generation. Such a misleading and confusing practice is unjustified and unnecessary, and cannot be allowed.

To avoid confusion and to furnish valuable information that consumers need and deserve, the standard offer rate must be unbundled. Customers' bills must show not only distribution, transmission, and generation charges, but also the stranded cost and system benefits charges that consumers will be paying. By looking at their electric bill consumers must be able to see that they are paying stranded cost charges whether or not they choose to switch generation providers. Consumers deserve to have information that will allow them to comparison shop for generation rates. This will raise the level of awareness of electric competition among consumers which ultimately benefits the market. This information will be readily available, because it must be unbundled for customers who switch to competitive generation. There is no reason not to clearly show generation charges on all customers' bills separately from stranded cost charges, unless the goal is to confuse and/or mislead them. As a result, unbundled charges <u>should</u> appear on <u>all</u> customers' bills, whether they are on the standard offer or are receiving competitive generation service.

2. <u>The Rate For The Generation Component Of The Standard Offer Should Be A Retail Market-Based Rate</u>.

The generation component of the standard offer should be set by the Commission to reflect a retail market based rate. Setting the standard offer generation rate based on the retail market price for generation should allow for a rate reduction for standard offer customers. The Commission should set this rate at the high end of the market price in order to allow new generation providers to effectively compete for consumers' business.

All of the Affected Utilities' generation-related costs must be correctly unbundled and included in their standard offer generation rate. New market entrants must recover their costs related to providing retail generation in their generation rates, and Affected Utilities must therefore allocate their retail generation-related costs in the same manner. Otherwise the Affected Utilities' retail generation service will be subsidized by other regulated services, leaving potential new market entrants unable to effectively compete. Without new market entrants, electric restructuring will be a sham, and all the Commission's efforts will have been for naught.

3. <u>Standard Offer Generation Rates Should Be Capped During The Transition Period At The Retail Market Based Generation Rate Set By The Commission</u>.

Page 18 of the Recommended Order expresses concern that rate protection for small consumers would exclude allowing transition costs for the Affected Utilities. The price cap RUCO recommends, however, is on generation rates. The retail market based generation rate should be set by the Commission, and this rate should be capped so that consumers do not pay more for generation when the generation market is opened to competition than they do now. If the generation rate is set based on retail market price as RUCO recommends, generation rates should go down, so that a rate cap will not be problematic.

B. The Recommended Net Revenues Lost Methodology Must Be Modified To Reflect A Life Of The Assets Calculation Period And A Retail Market Price Determination.

1. <u>Calculation of Stranded Costs Must Be Made Over The Life Of Generation Related Assets</u>.

To prevent substantial over-recovery of stranded costs, stranded cost calculations must be made over the life of the generation assets, and not only during the years when stranded costs are highest. The Recommended Order allows the Affected Utilities to calculate their stranded costs on a year-by-year basis for only five years. It is RUCO's position that stranded costs should be properly calculated over the operating life of the assets involved. Adoption of APS' year-by-year method of calculating stranded costs would improperly preclude the determination of the actual net present value of stranded costs. It is highly inequitable to the ratepayers to allow the Affected Utilities to "cherry pick" off the earlier operating years of generation assets, when stranded costs are high, and to simply ignore the later operating years of generation assets, when stranded costs will be negative. The negative stranded cost years of the operating life of generation assets must be included in stranded cost calculations in order to accurately assess stranded costs. The later, negative stranded cost years of the operating life of generation assets will partially offset the earlier, highly positive stranded cost years, resulting in a more accurate stranded cost calculation.

The methodology proposed in the Recommended Order ignores the years in the operating life of generation assets when stranded costs are low. This method would unfairly deprive ratepayers of the benefit of the later years of the formerly regulated assets' operating life. This approach would lead to ratepayers paying vastly more than 100% of actual stranded costs, a result which is wholly inequitable and entirely unacceptable.

Although the plan outlined in the Recommended Order reduces the competition transition charge ("CTC") by 20% each year for the five-year recovery period, its failure to account for the operating life of the generation assets still results in a immense overstatement of stranded costs. It is important to note also that the CTC is reduced only for customers who can and choose to buy competitive power. If the methodology outlined in the Recommended Order were to be adopted, the Affected Utilities' captive customers would be forced to bear the greatest proportion of the overstated stranded costs, while customers who can switch would pay considerably less. This scenario would be highly advantageous to the shareholders, who would stand to gain substantially more than 100% of the Affected Utilities' stranded costs, while still retaining ownership of the generation assets.

2. <u>Standard Offer Customers Must Not Be Penalized If They Cannot Enter The Competitive Generation Marketplace.</u>

The Recommended Order calls for customers remaining on the standard offer to pay 100% of their proportionate share of stranded costs while customers electing to purchase from competition would pay a cumulative 20% less each year during the transition period. RUCO agrees that imposing such a "shopping credit" plan may provide an incentive for customers to shop for competitive generation, and could contribute to a more robust generation market. However, some customers will be unable to enter the competitive market for various reasons. One of those reasons is due to the phase-in schedule, which has yet to be finalized. Another reason is that new market entrants are not likely to target all standard offer customers, due to geographic location and other factors. Those customers who cannot enter the competitive market must not be penalized for their inability to shop by being forced to bear a share of stranded costs greater than that of those customers who do have the ability to obtain competitive service.

C. Divestiture Sale Price Requires A Reasonableness Review.

The Recommended Order states: "[t]he difference between the net market value and book value will be stranded costs." This statement mischaracterizes the nature of stranded costs. Book value alone is not a relevant measure of stranded costs. Operating costs must also be considered, just as they are when revenue requirements are determined in order to set regulated rates. Using net book value alone, without operating costs, would ignore the relationship between operating costs and the market value of generated power. This would result in an unfair over-calculation of stranded costs to be borne by ratepayers.

In addition, any divestiture sale price must be reviewed by the Commission for reasonableness in order to assure that the public interest is served. An administrative determination of stranded costs must take place even if an Affected Utility chooses to divest.

RESPECTFULLY SUBMITTED this 29th day of May, 1998.

Stephen Gibelli
Staff Attorney, RUCO

AN ORIGINAL AND TEN COPIES
of the foregoing filed this 29th day
of May, 1998 with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

COPIES of the foregoing hand delivered/
mailed this 29th day of May, 1998 to:

Jerry Rudibaugh, Chief Hearing Officer
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Paul Bullis, Chief Counsel
Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Ray Williamson, Acting Director
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Craig Marks
Citizens Utilities Company
2901 North Central Avenue, Suite 1660
Phoenix, Arizona 85012

Barbara Klemstine
Arizona Public Service Company
P.O. Box 53999
Phoenix, Arizona 85072-3999

C. Webb Crockett
Fennemore Craig
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913

Betty Pruitt
Arizona Community Action Association
2627 N. Third Street, Suite 2
Phoenix, Arizona 85004

Michael M. Grant
Gallagher & Kennedy
2600 North Central Avenue
Phoenix, Arizona 85004-3020

Bradley S. Carroll
Tucson Electric Power Company
220 West Sixth Street
P.O. Box 711
Mail Stop DB203
Tucson, Arizona 85702

Douglas C. Nelson
Electric Competition Coalition
7000 North 16th Street, Suite 120-307
Phoenix, Arizona 85020

Phyllis Rowe
Arizona Consumers Council
6841 North 15th Place
Phoenix, Arizona 85014

Russell E. Jones
O'Connor, Cavanagh, Molloy, Jones
33 North Stone Avenue, Suite 2100
P.O. Box 2268
Tucson, Arizona 85702
Attorneys for Trico Electric Cooperative

Christopher Hitchcock
Hitchcock, Hicks & Conlogue
P.O. Box 87
Bisbee, Arizona 85603-0087
Attorneys for Sulphur Springs Valley Electric Coop.

Roderick G. McDougall, City Attorney
Jesse Sears, Assistant Chief Counsel
City of Phoenix
200 West Washington, Suite 1300
Phoenix, Arizona 85003-1611

William J. Murphy
City of Phoenix
200 West Washington, Suite 1400
Phoenix, Arizona 85003-1611

Andrew Bettwy
Southwest Gas Corporation
5241 Spring Mountain Road
Las Vegas, Nevada 89102

Debra Jacobson
Southwest Gas Corporation
5241 Spring Mountain Road
Las Vegas, Nevada 89102

Suzanne M. Dallimore
Antitrust Unit Chief
Department of Law Building
Attorney General's Office
1275 West Washington
Phoenix, Arizona 85007

Norman J. Furuta, Associate Counsel
Engineering Field Activity West
Naval Facilities Engineering Command
900 Commodore Drive, Building 107
San Bruno, California 94066-5006

Carl W. Dabelstein
2211 East Edna Avenue
Phoenix, Arizona 85022

Michael Block
Goldwater Institute
201 North Central Avenue
Phoenix, Arizona 85004

Larry K. Udall
Arizona Municipal Power Users Association
2712 North Seventh Street
Phoenix, Arizona 85006-1090

Jessica Youle
Salt River Project
PAB 300
P.O. Box 52025
Phoenix, Arizona 85072-2025

Lawrence V. Robertson, Jr.
Munger Chadwick PLC
333 North Wilmot, Suite 300
Tucson, Arizona 85711-2634
Attorneys for PG&E Energy Services

Tom Broderick
PG&E Energy Services
6900 East Camelback Road, Suite 800
Scottsdale, Arizona 85251

Lex Smith
Michael Patten
Brown & Bain, P.C.
2901 North Central Avenue
Phoenix, Arizona 85001-0400
Attorneys for Morenci Water & Electric
Ajo Improvement Co.
Phelps Dodge Corporation

Vinnie Hunt
City of Tucson
Department of Operations
4004 South Park Avenue, Building #2
Tucson, Arizona 85714

Steve Wheeler
Thomas Mumaw
Snell & Wilmer
One Arizona Center
400 East Van Buren Street
Phoenix, Arizona 85004-0001
Attorneys for Arizona Public Service Co.

Rick Gilliam
Land and Water Fund of the Rockies
2260 Baseline Road, Suite 200
Boulder, Colorado 80302

Michael A. Curtis
William P. Sullivan
Martinez & Curtis, P.C.
2712 North Seventh Street
Phoenix, Arizona 85006-0372
Attorneys for Navopache Electric Cooperative
Mohave Electric Cooperative
Safford, Wickenburg Irrigation & Electric District No. 2

Albert Sterman
Arizona Consumers Council
2849 East 8th Street
Tucson, Arizona 85716

Walter W. Meek, President
Arizona Utility Investors Association
2100 North Central Avenue, Suite 210
Phoenix, Arizona 85004

Elizabeth S. Firkins
International Brotherhood of Electrical Workers, L.U. #1116
750 South Tucson Boulevard
Tucson, Arizona 85716-5698

Choi Lee
Phelps Dodge Corporation
2600 North Central Avenue
Phoenix, Arizona 85004-3014

Myron L. Scott
Attorney at Law
1628 East Southern Avenue, No. 9-328
Tempe, Arizona 85282-2179
Attorney for Arizonans for a Better Environment

Robert S. Lynch
Attorney at Law
340 East Palm Lane, Suite 140
Phoenix, Arizona 85004-4529
Attorney for Arizona Transmission Dependent Utility Group
Irrigation and Electric District of Arizona

K. R. Saline
K.R. Saline and Associates
160 North Pasadena, Suite 101
Mesa, Arizona 85201-6764

Dan Neidlinger
3020 North 17th Drive
Phoenix, Arizona 85015

Barbara R. Goldberg, Deputy City Attorney
Fredda J. Bisman, City Attorney
Office of the City Attorney
3939 Civic Center Boulevard
Scottsdale, Arizona 85251

Terry Ross
Center for Energy and Economic Development
7853 East Arapahoe Court, Suite 2600
Englewood, Colorado 80112

Thomas W. Pickrell, Esq.
Arizona School Board Association, Inc.
2100 North Central Avenue
Phoenix, Arizona 85004

By Cheryl Fraulob
Cheryl Fraulob
Legal Secretary II